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Certified Development Company Program

U.S. Small Business Administration
Office of Finance and Investment
Office of Economic Development

SBA 1.2:

SBA

Certified Development Company Program

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INTRODUCTION

SBA and Small Business

Free competition is the base of America's economy. The U.S. Small Business Administration (SBA) was created to ensure that free competition will continue for the small business owner. The two primary functions of the Small Business Administration are to **foster new business**, and to **assist existing businesses** by offering financial and management services. Small Business Administration programs provide business owners with opportunities to use personal creativity, judgment, and initiative to compete in this economy. The SBA is committed to keeping small business opportunities alive.

The Certified Development Company Program Objective

The SBA's Certified Development Company (CDC) Program was enacted on July 2, 1980 as an amendment to the Small Business Investment Act of 1958. The Certified Development Company Program was created to fill a credit gap suffered by small and medium sized businesses. The credit gap results from the limited opportunities for small businesses to secure financing. Commercial banks are predominantly short to medium term lenders (5 to 10 years). Savings institutions are generally residential lenders. Large businesses can generate their own long term financing through the bond market, while small businesses cannot.

The primary objective of a CDC is to fill this credit gap by providing long-term fixed asset financing through a SBA guarantee. Certified Development Companies have authority under SBA's 504 Program (evolved from the 503 Program and enacted in 1986) to make SBA approved loans in the form of 100% guaranteed debentures. In addition to the 504 Program, a CDC has access to other SBA programs such as the 7(a) and 502 Programs. A successful CDC will also become a resource center that functions to meet the needs of business concerns by providing access to a variety of available federal, state, and local economic development programs.

Certified Development Company Success

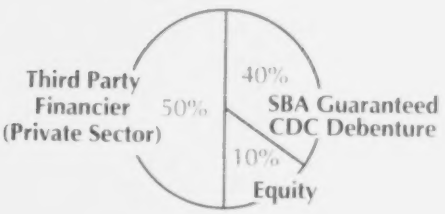
Since the start of the CDC Program in 1980 through fiscal year 1988, 495 companies have packaged 9,045 SBA approved loans for a total of $2 billion. Of those debentures approved, 6,782 have been purchased for a total of $1.4 billion in financing. Another $593 million in financing, approved and waiting for sale, proves the CDC Program to be a successful mechanism for small businesses in need of long-term financing.

OVERVIEW OF 504 FINANCING

Only Certified Development Companies (CDCs) may take part in the Small Business Administration's (SBA's) 504 Program. A 504 Loan is not possible without a Certified Development Company, and administration of this program is the primary function of these companies. An overview of 504 Financing is provided in this section to answer basic questions about the program. This overview is intended to provide only a general understanding of the program.

What is 504 Financing?

A complete 504 financial package is a combination of at least three sources: SBA, a CDC and private sector financiers. An example of participation in 504 financing is provided below:



- The SBA may guarantee up to the lesser of 40% or $750,000 (in the form of a debenture/bond) of any approved CDC project. The minimum amount SBA may guarantee is $50,000 (special circumstances may allow a $25,000 debenture).
- The SBA debenture amount combined with any other federal program funds may not exceed 50% of the total financing for the project.
- A CDC is required to inject at least 10% of the total financing for any project using a 504 Loan. This injection may come from the CDC's general fund or from the borrower (Small Business Concern) receiving the financial assistance.
- The remainder of the funding (50%) must come from a non-federal source such as a bank or other lending institution.

What is a SBA Debenture?

The SBA portion of the financing consists of aid in the form of a debenture, a type of bond. Debentures, pooled through a certificate mechanism, are sold to the public market. Each debenture is issued in connection with the making of a loan or leasing of assets by a Certified Development Company to a Small Business Concern (SBC). Each loan must be approved by SBA.

Repayment of a debenture begins on the first day of the month following its sale. Only a completed project can assure the SBC of the operating capacity needed to make payments, so interim financing will be needed. Once sold, debentures (and the Certificates representing an interest in a pool of debentures) are 100% guaranteed by SBA with a "Full Faith and Credit Guarantee" issued by the U.S. Treasury.

Machinery and equipment terms of the 504 Loan are 10 years and real estate terms are 20 years. Interest rates are based on current market rates for 5 and 10 year U.S. Treasury issues, plus a spread over the treasury rate based on market conditions.

What Type of Security do Debentures Require?

All debentures guaranteed under this program must be secured to ensure repayment. Collateral may include: a mortgage on the land and the building being financed; liens on machinery, equipment, and fixtures; lease assignments; and appropriate personal guarantees. If a SBC defaults, SBA will be responsible for full payment of the debenture to the investors. The third party financier (bank or other lending institution) has the security of a first lien on the land and building being financed, as well as other collateral involved. The SBA is secured by a second lien. The CDC (or SBC) injection into the project holds the most junior position.

What Projects Qualify for 504 Financing?

Only fixed asset projects qualify for 504 financing. The proceeds of a debenture may be used for the purpose of assisting a SBC with plant acquisition, construction, conversion, or expansion, including the acquisition of land. Proceeds may also be used for land and site improvements (e.g., grading, streets, parking lots, utilities, or landscaping); the acquisition and installation of machinery and equipment; and the interest on interim financing. Project costs may also include professional fees directly attributable and essential to the project (e.g., surveying, engineering, architectural, legal, or accounting).

Who is Eligible for 504 Financing?

A Certified Development Company (CDC) must demonstrate to the satisfaction of SBA that the desired financing for the SBC's project is not available from other sources. A SBC must meet the following criteria:

- It must be small. A business is considered small if it has 500 or fewer employees. For purposes of 504 financing, certain manufacturing companies may have more than 500 employees based on SBA size standard regulations contained in the Federal Code of Regulations, Business Credit and Assistance edition.
- The SBC's net worth must not exceed $6 million and its average net income after taxes for the preceding two years must not exceed $2 million.
- The SBC must be a for-profit corporation, partnership, or proprietorship.
- The SBC must have a "sound business" purpose.
- The SBC's project must demonstrate a significant economic impact on the community in which it is located, primarily through job creation or retention.

Who is Ineligible for 504 Financing?

504 Financing is not available to non-profit organizations; investment companies; gambling facilities; lending institutions such as banks or financing companies; and media such as newspapers, magazines, book publishers, radio, and television systems. Additionally, a SBC in which a CDC or any of its members has any equity interest is considered ineligible for 504 financing (this regulation may be waived for certain situations).

ORGANIZATION OF A CERTIFIED DEVELOPMENT COMPANY

A Certified Development Company (CDC) must be organized as a non-profit corporation. A CDC will consist of a specific membership and will operate in a specific area. A CDC must be organized according to the following regulations:

Membership Requirements

- A CDC must have a 25 person membership with adequate management experience.
- Membership must be geographically representative of the CDC's area of operation.
- Membership must be of "good character." Good character will be deemed absent if any member: is currently incarcerated, on parole, or probation; is convicted of a felony; has made a misrepresentation to SBA; or has been in violation of a law or regulation protecting the integrity of business.
- No member or shareholder in the CDC may have individual voting control of more than 10% of the total outstanding stock or membership of the development company.
- Membership must have representation from each of the four following areas:
  1. **Government** (from the organization responsible for economic development in the area at the corresponding level of government, whether local, county, or state)
  2. **Private sector lending institutions** (banks, savings and loan institutions, or insurance companies)
  3. **Community organizations** (such as foundations, trade associations, colleges, or universities)
  4. **Business organizations** (representatives from the business population in the area of operation, such as chambers of commerce or individual business concerns)
- Membership must elect at least five of its members to serve as the board of directors (it is advisable to have 8-10). There must be a President, Vice-President, Secretary, and Treasurer. The board of directors must have representation by three out of the four membership groups (above). At least one director must have commercial lending experience.
- The board of directors must meet quarterly.
- A quorum shall never be less than 5 directors of the board, and at least one member of the quorum must have commercial lending experience.
- The board of directors is responsible for making 504 financing decisions (for submission to the SBA field office located in the CDC's area of operation) and for staffing decisions.
- A CDC must have a full-time professional staff (at least one person available during regular business hours to handle day-to-day functions). The staff's responsibilities will include marketing, packaging, processing-closings, and loan servicing functions.

Area of Operation Requirements

- A CDC applicant must demonstrate the need for its services in a proposed area, and provide evidence of support from the appropriate level of government (city, county, or state) in the proposed area.
- A CDC will be certified to operate in a defined area; this area can not exceed the boundaries of its state of incorporation with the following exceptions (subject to SBA approval):
  1. area of operation bisects a contiguous economic area.
  2. area of operation includes a territory or possession of the U.S.
- A CDC, with SBA approval, may temporarily expand an area of operation to include an area underserved by 504 financing. If need requires, a CDC may apply for permanent expansion.
- Only one statewide CDC is permitted per state.

RESPONSIBILITIES OF A CERTIFIED DEVELOPMENT COMPANY

The primary function of a Certified Development Company (CDC) is to provide financial assistance to a specific area of operation through participation in the Small Business Administration's (SBA's) 504 Program. In addition, a CDC should develop into an economic resource center for its area of operation with information on and assistance from federal, as well as, state and local financial programs. A statewide CDC, while concentrating its efforts in assisting those areas not served by a local CDC, has the added responsibility of working with local CDCs to foster economic development throughout the state. To retain certification a company must uphold the following regulations and responsibilities:

The 504 Program

Marketing. To ensure participation, financial services must be visible to the Small Business Concerns (SBCs) and the lending institutions in the CDC's area of operation. A CDC is responsible for all publicity on the 504 Program.

Evaluation. A CDC is responsible for the initial evaluation of the SBC and its project. "Sound judgment" must be exercised. A CDC should recognize SBCs which meet the eligibility requirements of the 504 Program.

Activity Level. To retain certification, a CDC must make two 504 loans per year unless a written justification for inactivity is submitted to and approved by SBA .

Diversification. A CDC must have a diversified loan portfolio, i.e., it must not be concentrated in any one type of business or with only new businesses (those businesses in operation for less than two years).

Packaging. A CDC is responsible for the physical packaging of the loan application. A CDC must ensure that the application package is complete, and must be willing to assist the SBC with preparation of the documents required for application.

CDC Injection. A CDC is required to inject at least 10% of the total 504 project. This injection may come from the CDC, the SBC receiving the loan, or other local sources.

Servicing. A separate file for each 504 Loan must include the following: SBA loan authorization, all documents and correspondence relating to the loan, all documents related to loan closing and debenture sale, evidence of the CDC's injection into the project, financial statements of the small concern, evidence of CDC field visits, reports on condition of collateral, evidence of the SBC's payment of taxes and insurance, and all other items relevant to the loan.

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The 504 Program
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504 Alterations. A CDC must have SBA approval for any alteration in a 504 loan authorization. An alteration request (Form 327) must be completed and submitted to the SBA branch or district office at which the loan was approved.

Administrative Costs. A CDC may charge fees to the SBC for administrative costs and professional fees associated with loan servicing. A CDC is required to disclose the full amount of all fees and charges, together with the receipts and a description of the services rendered. This report must be submitted to SBA with the 504 loan application.

CSA Contract. A CDC is required to enter into a contract with the Central Servicing Agent (CSA). The CSA disburses funds, collects monthly loan payments, and provides accounting and other servicing functions.

Opinion of Good Standing. Following the completion of a 504 project, the CDC must issue to SBA an opinion on the repayment capability of the SBC. If no adverse condition that would affect the SBC's payment capability exists, a debenture for the SBA amount of the project will be sold.

Debenture Closing. A CDC is responsible for all procedures and document preparation necessary to the closing of all projects approved by SBA. The SBA counsel will be available for advice and assistance. The complete loan closing package must be submitted to the appropriate SBA field office no later than the date prescribed by that field office for inclusion in the next debenture sale.

Debenture Payments. A CDC is responsible for servicing the note to ensure the availability of funds for the timely payment of the debenture.

Report on Delinquent Payments. A CDC must submit to SBA a quarterly written report on any account in its portfolio which is sixty days or more past due. The report must explain the reason for non-payment, and the steps being taken by the company to bring the account current.

Preference. A CDC is prohibited from making any agreement to receive any side collateral or guarantee that would secure only its own interest in a loan.

General Operations

Communications. Once certified, a CDC must direct all questions regarding policy or procedure to the SBA branch or district office responsible for the area where the CDC is headquartered.

Resource Center. A CDC should become a resource to its community, willing to match Small Business Concerns to local, state, federal and other SBA programs in addition to the 504 Program.

Portfolio Assumptions. A CDC must have SBA approval to assume the loan portfolio of another CDC.

Documents. A CDC must submit (at its own expense) any documents or copies requested by SBA. A CDC must also assist SBA in obtaining documents from any Small Business Concern receiving a SBA loan.

Records. A CDC must keep records of financial statements and accounts, minutes of meetings, lists of committees and members, and all other documents relevant to its operations.

Annual Report. A CDC must submit to its SBA field office an annual report within 90 days of its fiscal year end. This report must contain financial statements, assessment of needs and resources available, explanation of the company's loan activity, and accomplishments for the year then ended, plans for the upcoming year, and personal resumes of new directors, and professional staff employed by the CDC.

Operational Review. A CDC will be subject to an annual operational review by SBA. The review will take place by appointment during business hours after the annual report has been evaluated. The SBA branch or district office conducting the review will submit an operations report to the Central Office in Washington for evaluation. The SBA reserves the right to require corrective actions, to temporarily suspend certification, or to reverse certification of any CDC. Such actions will not invalidate any guarantee on loans previously issued by the CDC.

Litigations. A CDC must notify SBA in writing within thirty calendar days of any litigations brought against the company or its members, officers, or directors.

CDC Alterations. Any alteration in the CDC's organization (e.g., CDC's name, address, telephone number) must be reported to SBA within thirty days after the change has taken place.

Decertification. A CDC wishing to become decertified must contact the nearest SBA branch or district office. Written notification and the Certificate of Operation must be submitted to SBA. Services must be provided, in some manner, for all outstanding loans.

CERTIFICATION PROCESS

Procedure

A prospective Certified Development Company must submit an application to the SBA branch or district office responsible for the area where the CDC will be headquartered. If approved, the SBA regional office will review the application and forward it, along with its recommendation, to the Office of Economic Development (OED), Washington, DC, for final approval of the Company. Qualified companies will receive a certificate evidencing eligibility for participation in the CDC Program.

If an application is declined, the proposed CDC will be notified in writing of the specific reason for refusal. The applicant will have a sixty day time period in which to resubmit the application to the branch or district office at which it was originally submitted. If the application is declined a second time, the applicant may appeal the decision to the regional administrator. Appeals stop at the regional level.

The Application Package

A company meeting the qualifications outlined in this brochure may submit an application (Form 1246) for certification. The application package should be well-organized and labeled. No application will be evaluated until all documents are present. A proposed company must submit the following documents.

1. A certified copy of public notice (by way of newspaper of general circulation) must be given to the area in which the CDC will operate. The notice should contain the following information: name, location, purpose, area of operation, and names and addresses of officers, directors, and members. This notice should be sent to the local SBA branch or district office within 10 days of date of publication. A reasonable time should be allotted for the public to submit written comment about the proposed CDC to the SBA for final approval.

2. Articles of incorporation and bylaws for the CDC. The incorporation papers must have wording indicating that the CDC's chief purpose is to "further economic development and promote and assist the growth and development of small business concerns in its operation area" and "any monetary profit or other benefits which flow to shareholders (members) shall be incidental to the corporation and shareholders."

3. A resolution from the board of directors which gives the corporation the authority to request certification from SBA (Form 1247).

4. A commitment letter identifying the level of support from the corresponding area of government included in the CDC membership.

5. List of officers, directors and members with the following information on each individual: name, address, telephone number, occupation and percentage of voting control.

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The Application Package *(continued)*

6. Statement that no member controls more than 10% of the development company stock or voting membership.

7. "Statement of Personal History" on each officer and director (Form 1081).

8. List of staff including the following information: name, address, telephone number, resume, specific function of each individual, salary, and relationship (if any) to any member of the CDC.

9. List of persons performing special services for the CDC such as legal and accounting. Identify the specific function provided by each individual and their related experience. A signed copy of any contract, disclosing fees, must be enclosed with the application.

10. The CDC's exact area of operation (map or written description of boundaries) and the name of place of business, location, and hours.

11. The CDC's detailed operating plans including goals for the first two years of operation. A plan of the CDC's evaluation, processing, and servicing functions must be included (use a flow chart).

12. Financial statements and budgets for the first two years. The CDC must submit a budget to SBA demonstrating the availability of adequate resources. A CDC must be able to sustain itself with reliable sources of funds such as income from services rendered, contributions from government, or other financial sponsorship.

CONCLUSION

A Certified Development Company should become an economic development tool ready to be used to meet the individual needs of its community. These needs will be diverse: from government and local loans to procurement contracts, to import/export trade for small concerns, to neighborhood and city revitalization projects. It is the expectation of SBA that a CDC will become an indispensable asset to its community without losing sight of the original purpose of the company: to act as a liaison between SBA (specifically packaging 504 financing) and Small Business Concerns. The utilization of SBA's Certified Development Company Program will help to ensure the continued contribution of small business to the economic well-being of America.

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